

## Management Discussion and Analysis

### MARKET REVIEW

The economy for China continued to grow robustly with GDP growth of 9.6 percent in 2004. The austerity measures implemented by the Chinese government have minimal or no implication on the healthcare industry. The Chinese healthcare industry continues to modernize and has become one of the fastest growing healthcare markets in the world over the last decade, growing at an annual average rate of over 16 percent. Underpinning such phenomenal growth are enhanced living standard, increase in per capita, growth of the aging population, increasing healthcare consciousness, and market oriented industry reforms driven by the Chinese government.

According to the World Health Report 2004 published by the World Health Organization, China was way behind on healthcare services compared with developed countries. Medical and healthcare services in the developed countries accounted for 7.5 percent of GDP on average in 2001. Medical and healthcare services in the US represented 13.9 percent of GDP, while the figure for China was only 5.5 percent in 2001. It is widely expected that demand for medical and healthcare services will continue to grow as consumers become more affluent.

### BUSINESS REVIEW

#### Strategic Prioritization of Resources (“SPOR”)

Through its subsidiaries, the Group is principally engaged in three business divisions, namely, IT products and services, protein chips and property investment.

Currently, the Group’s protein chip business division manufactures and distributes protein chips and related systems (“C12 products”) to hospitals and life insurance companies in China. The C12 products are capable of detecting up to twelve tumor markers simultaneously and assisting in early detection of ten prevalent cancer tumor types.

During the year, the Group has experienced a robust performance in both order and sales of C12 products. As a proven and leading supplier of protein chips in China, the Group began to supply C12 products to life insurance companies based in China with C12 products for the pre screening and general health appraisal of life policy applicants. The Group expects the overall growth for the protein chips sales to be promising and sustainable in the future.

The Group commenced operation SPOR to shift resources allocation from the IT products and services and property investment divisions to the high growth protein chips division, during the year. The Group believes that the objectives of operation SPOR which are based on a number of considerations such as market potential, profitability margin and risk assumptions will further clarify and strengthen the Group’s long term corporate strategy to develop itself into a global supplier of protein chips for the early detection of diseases.

In December 2004, the Group disposed all its key investment properties and the additional resources will be reallocated to the development of protein chip operations. In addition, the Group is committed to downsize or dispose the remaining IT products and services business division in an orderly manner in the foreseeable future.

### **Mission Statement – A Transformed Mission Approach**

As a leading supplier of protein chips in China, the Group dedicates itself to providing low cost, non invasive and wide range of biotechnology products such as protein chips for early detection of diseases.

The Group believes that early detection of potentially fatal diseases significantly improves the chances of successful medical therapy and treatment, raises the survival rate and improves the quality of life for patients. Through a continuous pursuit of technology innovations and successful commercialization of products, the Group strives to improve the quality of life for all humans and to assist life insurance industries in the evaluation of life span.

### **Protein Chips**

The Group had an excellent year for this division and sold a total of 714,058 protein chips (2003: 332,494), representing an increase of 114 percent over that of last year. During the year, the Group further strengthened its sales efforts to life insurance companies with the successful signing of Ping An Life, China Life (Chengdu) and China Life (Overseas) as its customers. The Group expects that the sales to life insurance companies will continue to improve significantly in the foreseeable future.

The significant increase was due mainly to a number of the following factors:

*Sales network* – Building on past sales' experiences, the Group has established a more comprehensive pricing structure tailored for direct sales, distributorships and life insurance companies. Without the hindsight of affecting profit margins for the Group, the pricing strategy includes volume discounts, prompt rebates, seasonal adjustments, etc. During the year, the Group successfully restructured the nationwide distributorships methodology that is built on the common goal of long term business development and profitability. At the same time, the new structure encourages competition among distributors, and attracts more potential distributors.

*Chipreader optimization plan* – As at 31st December, 2004, the Group had 240 chipreaders in the market. The Group understands that the chipreader for the C12 chips is a principal contributing factor for the sales volume and to this effect, the Group has devised an optimization strategy that implement plans to increase the utilization rate per chipreader per month by promoting the sharing of chipreaders among hospitals in any one location, reallocating some existing chipreaders to newly signed up hospitals and insurance companies, and increasing the production of chipreaders to meet new demands. During the year, the implementation of the optimization plan for chipreaders also contributed significantly to the increase in sales volume for the C12 protein chips.

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*Chipset packaging diversification* – The Group original chipset consists of 48 wells for the simultaneous testing of 42 patients. During the year, the Group introduced two new and smaller packaging for the chipsets, namely 24 wells for the testing of 18 patients and 16 wells for the testing of 10 patients. The smaller packaging is more popular with regional hospitals and allows for more regular processing of C12 protein chips for patients.

### Property Investment

Property investment division has generated a steady and increasing flow of rental income for the Group. However, following the disposal of substantially all of the investment properties in December 2004, the division is not expected to be a major contributor to the Group's overall performance starting from 2005.

### IT Products and Services

This division performed steadily this past year. Due to operation SPOR, the Group intends to dispose or downsize this division in 2005.

## FINANCIAL PERFORMANCE

The consolidated turnover of the Group amounted to HK\$523.6 million (2003: HK\$456.0 million) for the year under review, representing an increase of approximately 14.8 percent over that of last year. The increase in turnover was mainly attributable to improvements in all three business divisions, namely protein chips, property investment and IT products and services.

The net profit attributable to shareholders amounted to HK\$67.0 million (2003: HK\$33.7 million), representing an increase of 98.8 percent over that of last year. The increase was due to the significant increase in contribution from the protein chips division which represented approximately 82.2 percent of the group's profits. Earnings per share was HK2.50 cents (2003: HK1.41 cents), representing an increase of approximately 77.3 percent.

### Protein Chips

Turnover contributed by the sale of C12 products and related equipment amounted to HK\$78.8 million (2003: HK\$33.0 million), representing an increase of approximately 138.8 percent over that of last year. More importantly, segment profits of the protein chips division amounted to HK\$54.9 million (2003: HK\$28.2 million), representing an increase of approximately 94.9 percent over that of last year.

### Property Investment and IT Products and Services

Operation SPOR affected the results of property investment and IT products and services divisions in the second half of 2004. While the consolidated turnover from these two divisions showed a modest increase, the segment profits from these two divisions actually declined over that of last year.

*Property investment* – Turnover contributed by this division amounted to HK\$15.1 million (2003: HK\$10.6 million), representing an increase of 42.4 percent over that of last year. The segment profits for this division amounted to HK\$7.5 million (2003: HK\$3.3 million), representing an increase of approximately 125.3 percent over that of last year. The increase in both turnover and results was due to the fact that most of the properties were acquired by the Group in 2003.

*IT products and services* – Turnover contributed by this division amounted to HK\$429.7 million (2003: HK\$412.3 million), representing an increase of 4.2 percent over that of last year. Due to operation SPOR, the Group reduced resources allocated to this division and the segment profits amounted to HK\$6.6 million (2003: HK\$13.3 million), representing a sharp decline of approximately 50.4 percent.

## PROSPECTS

### Protein Chips

#### *Background*

Leveraging its proprietary biotechnology platform and ideas, the Group is well positioned to service the increasingly health conscious and affluent group of customers in China who demand a higher standard of healthcare service and are looking for ways to improve quality of life including early medical therapy and treatment of diseases through early detection. The Group's protein chips are designed for early detection of diseases. With increasing health conscious worldwide and increasingly tight medical resources, the Group believes the dynamic development of biotechnology provides a new trend in healthcare industry that is moving decisively in the direction of early detection and prevention of diseases.

During 2003, the Group laid down key milestones for its protein chips business division (referred to as "KM2003 Objectives") and the Group has since been implementing business plans and strategies in the direction of KM2003 Objectives with an intention to strengthen its leading position as a protein chip supplier in China which is one of the largest, fastest growth and most promising markets in the world for healthcare products and services, including medical diagnosis products and services.

Despite many challenges ahead, the outlook for the Group is extremely promising and business plans are being implemented with impressive results. Most importantly the Group has successfully raised the required funds for the execution of its business plans through equity and debt issues, and through operation SPOR.

The Group continues to comply with a disciplined cost control philosophy and to adopt a methodical approach towards the implementation of its business plan that includes the strengthening distribution network and systems, upgrading production and quality control processes, and reviewing of its research and development efforts and effectiveness, etc. The Group believes that early diagnosis of potentially fatal diseases significantly improves the chances of successful treatment and raises the survival rate of patients. The Group intends to provide early screening of potential illnesses of discomfort that may be cured via proper dieting and drug therapy and thus raising the quality of life for patients.

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### *Key Milestones Progress*

Based on KM2003 Objectives, the Group is committed to achieving key milestones and a summary of their respective progress are provided below:

- (1) Expand production capacity for the protein chips.

The Group successfully completed the feasibility study for the construction of a new plant at the Songjiang Industrial Zone in the outskirts of the City of Shanghai and it is expected that construction work will begin in the first half of 2005. The new plant will have a total production capacity of 8 million chips and will be a production base for a range of protein chips used for screening and diagnosis of different diseases. The new plant will apply to the China State Food and Drug Administration (referred to as "SFDA") for a Good Manufacturing Practice Certificate (commonly known as "GMP"). It is expected that Phase I of the new plant will be operational before the end of 2006.

- (2) Commence mass production of various protein chips and systems.

The Group is currently operating a plant at the Huzhou Economic & Technological Development Zone in the Zhejiang Province (the "Huzhou Plant") with a production capacity of 1.5 million chips per annum. The Group's flagship C12 chips are currently produced at this GMP complaint plant and the Group intends to expand production capacity of the Huzhou Plant by at least 25 percent by the first quarter of 2006.

- (3) Build and strengthen the distribution channels and after-sales support services.

The Group currently distributes its C12 products to over 30 health centers for major insurance companies and over 220 hospitals in China through regional distributorships and direct sales. The Group will further expand the points of service to a total of 800 hospitals and health centers of insurance companies. At the new plant site, the Group will build a composite training center to train medical and healthcare personnel on handling protein chips and systems and provide after-sales services for customers.

- (4) Commit resources in marketing and promotional activities for different protein chips.

The Group markets and promotes protein chips under the brand name "HealthDigit". Currently, the Group is gaining increasing recognition for its product quality and corporate credibility. The Group intends to further leverage its first mover advantage and market leadership position by investing additional resources on the promotion and cultivation of the brand name "HealthDigit" and on the Group's protein chip technology and related products.

- (5) Pursue new research, discovery and product innovations.

The Group continues to conduct research in house on different applications of protein chips to be used for early detection of diseases. The Group will continue to cooperate and seek opportunities to work with established scientific research institutions and laboratories on the discovery and research on new product and applications. The Group has specific plans to launch new products such as protein chips for the detection of autoimmune and infertility diseases and to introduce new improved version of the C12 products within the next 36 months.

- (6) Establish global platform for the protein chips and systems.

While the major market for the Group is China, the Group has commenced feasibility studies on various markets outside China and intends to work with partners and regulators in their respective native countries for the distribution of “HealthDigit” protein chips and systems. While the Group recognizes that China is its major market, the Group also intends to formulate a comprehensive marketing and distribution strategy for overseas markets.

#### *New Line of Protein Chips for the Early Detection of Diseases*

In addition to the existing C12 products, the Group maintains a tight schedule for the introduction and launch of new types of protein chips. The following represents some of the protein chips that the Group plans to introduce to the market in the coming years:

- Protein Chip for Rheumatoid Autoimmune Diseases (referred to as “RAD”)

Autoimmune diseases affect an estimated 3 to 5 percent of the total population with the highest prevalence in the elderly. Being a major category of the autoimmune diseases, rheumatoid disorders are difficult to recognize in the early stage, but in late stages, multiple organs can be affected and damage can be irreversible.

The word “auto” is the Greek word for self. The immune system is a complicated network of cells and cell components (called *molecules*) that normally defends the body and eliminates infections caused by bacteria, viruses, and other invading microbes. If a person has an autoimmune disease, the immune system mistakenly attacks itself, targeting the cells, tissues, and organs of the person’s own body. A collection of immune system cells and molecules at a target site is broadly referred to as inflammation.

Rheumatoid disorders include systemic lupus erythematosus, rheumatoid arthritis, Sjogren’s syndrome, scleroderma, polymyositis/dermatomyositis and mixed connective tissue disease.

The clinical tests for RAD protein chip have been successfully completed and the Group has submitted to SFDA for the approval and grant of new drug certificate for the RAD protein chip. It is estimated that over 50 million people in China suffered from rheumatoid autoimmune diseases.

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- Protein Chip for Infertility and Sterility Diseases (referred to as “ISD”)

The protein chip is used to diagnose certain autoimmune disorders that cause infertility and sterility. Such disorders include endometriosis, recurrent spontaneous miscarriage, and dysfunction of the ovary and sperms.

The research and development work for ISD has been completed and clinical tests will be commenced in 2005. The Group intends to submit the ISD protein chips to SFDA for approval in 2005. It is estimated that over 20 million people in China suffered from infertility and sterility diseases.

- Improved Version of C12 Protein Chip (referred to as “C12A”)

The Group has further modified the existing C12 protein chips to improve the overall sensitivity from the average of 80 percent by at least 5 percent and to strengthen the level of specificity.

The research and development work for C12A has been completed and clinical tests will be commenced in the second half of 2005. The Group intends to submit the C12A protein chips to SFDA for approval in 2005.

### *Non Protein Chips*

Since the initiation of operation SPOR, the Group has been successful in disposing all its key investment properties in 2004 and will implement an orderly plan for the complete disposal or downsizing of its IT products and services division in 2005. When operation SPOR is successfully executed, the Group’s main focus will be medical diagnostic and healthcare products and services particularly in the area of early detection of diseases using biochips technology.

### *Conclusion*

As a leading supplier of protein chips and solutions for early detection of diseases in the high growth healthcare industry in China, the Group appreciates the many challenges and risks that are associated with the high growth industry and believe that the Group is reasonably well placed to respond to the risks and challenges accordingly. The Group believes that the business plan for KM2003 Objectives will be executed with precision and changes will only be made when there is a need to do so.

On a broader front, the Group will continue to expedite its business growth by actively pursuing new investment opportunities through strategic acquisitions or partnerships with good potential or synergies. Finally, the Directors believe that the Group will continue to enjoy respectable growth in sales in C12 products and to benefit from diversification in other protein chips in the foreseeable future.

## LIQUIDITY AND FINANCING

The Group adopts a prudent approach in managing its liquidity and treasury function and sets out guidelines to achieve these objectives. These guidelines cover the Group's debt profile, financing horizon and interest rate risks management.

At 31st December, 2004 the Group had cash and bank balances of HK\$123.5 million (2003: HK\$28.0 million). The Group's gearing ratio as at 31st December, 2004 was 8.6 percent (2003: 22.1 percent), based on bank and other borrowings of HK\$33.1 million (2003: HK\$64.4 million) and shareholders' fund of HK\$383.1 million (2003: HK\$291.6 million).

The Group's bank borrowings were denominated in Hong Kong Dollars and Renminbi. Bank borrowings totaling HK\$33.1 million were outstanding as at 31st December, 2004. Annual interest rates of the borrowings denominated in Hong Kong Dollars and Renminbi as at 31st December, 2004 were approximately 2.4% and 5.80% respectively.

Revenue generated from protein chips operation, rental income generated from investment properties in China, and the payment for purchases of materials, components, equipment and salaries are made in Renminbi. Use of financial instruments for hedging purposes is considered unnecessary and the exposure to exchange rate fluctuation is minimal.